(1) Supreme Court, U.S.
FILED
02-71 JUL 10 2002
OFFICE OF THE CLERK

No. _____

In the Supreme Court of the United States

1-800-FLOWERS.COM, INCORPORATED,
FRESH INTELLECTUAL PROPERTIES, INCORPORATED,
AND 800-FLOWERS, INCORPORATED,
Petitioners,

v.

CURTIS P. JAHN AND
CAPITOL WAREHOUSING CORPORATION,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

WILLIAM M. CONLEY
Counsel of Record
SHARON MOLLMAN ELLIOTT
FOLEY & LARDNER
150 E. GILMAN STREET
POST OFFICE BOX 1497
MADISON, WI 53701
(608) 257-5035

Counsel for Petitioners

BECKER GALLAGHER LEGAL PUBLISHING, INC.,
CINCINNATI, OHIO 800-890-5001

52 pg

QUESTIONS PRESENTED

The respondents entered into a contract purporting to sell a toll-free telephone number in exchange for a perpetual royalty on the use of that number. The FCC – which had long prohibited attempts to establish any ownership interest in toll-free telephone numbers – later promulgated a formal rule expressly forbidding the sale of a toll-free telephone number for profit.

1. Is express congressional authorization required for an FCC rule to bar the payment of *future* royalties for the sale of a toll-free telephone number?

2. May a federal court enforce a private contract that violates express public policy?

PARTIES TO THE PROCEEDINGS

The parties to the proceedings in the Court of Appeals for the Seventh Circuit were plaintiffs-appellants Curtis P. Jahn and Capital Warehousing Corp., and defendants-appellees 1-800-Flowers.com, Inc., Fresh Intellectual Properties, Inc., and 800-Flowers, Inc.

Petitioner 1-800-Flowers.com, Inc. is the parent company of petitioners Fresh Intellectual Properties, Inc., and 800-Flowers, Inc. 1-800-Flowers.com, Inc. is publicly held and owns more than 10% of the stock of both Fresh Intellectual Properties, Inc., and 800-Flowers, Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES iv

OPINIONS BELOW 1

JURISDICTION 1

REGULATION 1

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE WRIT 6

I. THE SEVENTH CIRCUIT'S DECISION CONFLICTS WITH THE DECISIONS OF OTHER CIRCUITS. 6

II. THE DECISION BELOW IS INCONSISTENT WITH THIS COURT'S DECISION ON RETROACTIVITY 9

III. THE DECISION BELOW CONFLICTS WITH THIS COURT'S DECISIONS FORBIDDING FEDERAL COURTS FROM ENFORCING CONTRACTS THAT VIOLATE PUBLIC POLICY 10

CONCLUSION 14

TABLE OF AUTHORITIES

CASES

Bergerco Canada v. United States Treasury Department, 129 F.3d 189 (D.C. Cir. 1997) . . . 8

Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988) . . . . . *passim*

DIRECTV, Inc. v. FCC, 110 F.3d 816 (D.C. Cir. 1997) 8

FCC Letter to Joseph J. Weiss, 13 F.C.C.R. 4122 (1977) 5, 12

FDIC v. Faulkner, 991 F.2d 262 (5th Cir. 1993) 7

Hurd v. Hodge, 334 U.S. 24 (1948) 10, 11, 13

Independent Petroleum Association of America v. DeWitt, 279 F.3d 1036 (D.C. Cir. 2002) 8

Landgraf v. USI Film Products, 511 U.S. 244 (1994) 6, 9

Louisville & Nashville R.R. v. Mottley, 219 U.S. 467 (1911) 10, 11, 12, 13

National Medical Enterprises, Inc. v. Sullivan, 957 F.2d 664 (9th Cir. 1992) 7, 8

Norman v. Baltimore & Ohio R.R., 294 U.S. 240 (1935) 10, 11, 13

Patients Plus, Inc. v. Long Distance Telecommunications Service, Inc., 13 F.C.C.R. 5827 (1997) 5

U.S. AirWaves, Inc. v. FCC, 232 F.3d 227 (D.C. Cir. 2000) 7, 8

W.R. Grace & Co. v. Local Union 759, 461 U.S. 757 (1983) 10, 11

STATUTES AND REGULATIONS

28 U.S.C. § 1254 1

47 C.F.R. § 52.107 . . . . . *passim*

MISCELLANEOUS

John K. McNulty, *Corporations and the Intertemporal Conflict of Laws*, 55 Cal. L. Rev. 12 (1967) 7

Petitioners respectfully petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The Seventh Circuit's opinion and Judge Flaum's concurrence are reported at 284 F.3d 807 (7th Cir. 2002), and reprinted at App. 3a. The contrary opinion and order of Judge Crabb for the United States District Court for the Western District of Wisconsin is unreported and reprinted at App. 12a.

JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on March 22, 2002. App. 3a. The Court of Appeals entered an order denying a timely petition for rehearing and rehearing *en banc* on April 23, 2002. App. 1a.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

REGULATION INVOLVED

47 C.F.R. § 52.107: **Hoarding**.

> (a) As used in this section, hoarding is the acquisition by a toll free subscriber from a Responsible Organization of more toll free numbers than the toll free subscriber intends to use for the provision of toll free service. **The definition of hoarding also includes number brokering, which is the selling of a toll free number by a private entity for a fee.**

(1) Toll free subscribers shall not hoard toll free numbers.

(2) No person or entity shall acquire a toll free number for the purpose of selling the toll free number to another entity or to a person for a fee.

(3) Routing multiple toll free numbers to a single toll free subscriber will create a rebuttable presumption that the toll free subscriber is hoarding or brokering toll free numbers.

(b) *Tariff Provision.* The following provision shall be included in the Service Management System tariff and in the local exchange carriers' toll free database access tariffs:

> [T]he Federal Communications Commission ("FCC") has concluded that hoarding, defined as the acquisition of more toll free numbers than one intends to use for the provision of toll free service, as well as **the sale of a toll free number by a private entity for a fee, is contrary to the public interest** in the conservation of the scarce toll free number resource and contrary to the FCC's responsibility to promote the orderly use and allocation of toll free numbers.

(Emphasis added.)

STATEMENT OF THE CASE

This case concerns the secondary retroactivity of an FCC rule and tariff forbidding the sale of toll-free telephone numbers for a fee, and the power of federal courts to enforce future payments under a private contract that violates the FCC's express public policy by requiring ongoing payments for the sale of a toll-free telephone number.

The toll-free telephone number that spells "1-800-FLOWERS" was randomly assigned in 1976 to Madison Truck Brokers, a company owned and operated by respondent Curtis Jahn. App. 14a. Jahn later founded another company, respondent Capital Warehousing Corporation, and transferred the FLOWERS number to it. *Id.* Capital Warehousing (wholly owned by Jahn) continued to use the number in the operation of its warehouse and trucking business until 1982. Id.

In 1982, Jahn and Capital Warehousing (collectively "Jahn") agreed to sell the FLOWERS number in exchange for a perpetual royalty on flower sales made over that number. App 27a. The agreement, which was amended in 1986, allowed the purchaser to assign the FLOWERS number, but provided that any assignee was required to assume the perpetual royalty obligation. App. 18a. Jahn has received over $1 million for the sale of the number under the agreement. App. 22a.

Nonetheless, Jahn wants more. Jahn brought suit in the Western District of Wisconsin to enforce the contract against the number's current subscriber, petitioner 800-FLOWERS, Inc. and related companies, claiming entitlement to even greater royalties for the sale of the FLOWERS number. App. 12a. Petitioners sought summary judgment on

the ground (*inter alia*) that the contract was unenforceable because the FCC prohibited the selling of a toll-free number for a fee. App. 13a.

Judge Crabb held that Jahn had sold a toll-free number for a fee, and that the contract would be illegal if entered into after the FCC promulgated a 1997 rule expressly prohibiting such sales. App. 27a. She found that the law before 1997 was not as clear, although she did note that prior law and FCC policy prohibited subscribers from claiming or establishing any "proprietary interest" in toll-free numbers, App. 21a, and that the FCC had ruled that "attempting to negotiate the transfer of a toll-free number for profit" was contrary to its longstanding policy. App. 23a. Still, Judge Crabb found it unnecessary to address whether Jahn's contract was legal when made or whether the 1997 rule applied retroactively, for petitioners did not seek disgorgement of the $1 million Jahn had already received. App. 27a, 30a. Instead, Judge Crabb focused on the fact that the *ongoing* payment "violates Federal Communications Commission policy and 47 C.F.R. § 52.107(a)'s prohibition against selling toll-free numbers for a fee." App. 27a. Because the ongoing, future payments were against the public policy codified in 47 C.F.R. § 52.107, Judge Crabb refused to enforce the contract under Texas law, granting summary judgment to petitioners. App. 30a.

The Seventh Circuit reversed. In the principal opinion, Judge Easterbrook assumed that a contract for the sale of a toll-free number would be illegal if entered into today. App. 5a. In a concurring opinion, Judge Flaum concluded that it would be. App. 11a. The court accepted Judge Crabb's uncontested finding that Jahn's contract was for the sale of a toll-free telephone number, App. 5a, yet reversed, focusing on the two questions Judge Crabb found

unnecessary to reach: whether the contract was legal when made and whether the rule could be applied retroactively. App. 8a-9a.

First, the Seventh Circuit looked at whether the amended agreement for the sale of the number was valid when it was entered in 1986. According to the FCC, attempting to profit from the transfer of a toll-free number is contrary not just to the 1997 rule, but "to the longstanding Commission policy prohibiting the establishment of ownership interests in toll free numbers." App. 23a (quoting *FCC Letter to Joseph J. Weiss*, 13 F.C.C.R. 4122 (1997)). That policy was expressed in tariffs filed with the Commission in the early eighties, which specifically provided that subscribers had no "interest or proprietary right" in any given toll-free telephone number. App. 21a. The FCC concluded that because subscribers had no proprietary interest in toll-free numbers, they were prohibited from selling such telephone numbers even before 1997. *See* App. 24a (quoting *Patients Plus, Inc. v. Long Distance Telecommunications Service, Inc.*, 13 F.C.C.R. 5827 (1997)).

The Seventh Circuit dismissed this argument as "untenable." App. 8a. Looking to leaseholds and internet domain names as analogies, the court concluded that the FCC's explicit prohibition on attempts to establish ownership interests in toll-free numbers did not in any way restrict subscribers from selling toll-free numbers before 1997. App. 8a-9a.

Having determined that the contract was valid when made, the court then considered whether the subsequent 1997 rule could apply to the ongoing payments required by the contract. App. 9a. Citing *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), the court ruled that because

Congress had not authorized the FCC to adopt regulations with retroactive effect, the FCC rule could not be applied retroactively to affect the 1986 contract – or even the continuing obligation to pay *future* royalty payments under the contract. App. 8a-9a. Making no distinction between primary and secondary retroactivity, the Seventh Circuit determined that applying the rule to bar future payments would have a retroactive effect. *Id.* Indeed, it ruled that "[c]hanging today's financial consequences of an earlier transaction is the paradigm of retroactivity" requiring express congressional authorization. App. 9a.

REASONS FOR GRANTING THE WRIT

This case presents important questions regarding the scope of the presumption against retroactivity and the power of federal courts to enforce private contracts that violate public policy.

I. THE SEVENTH CIRCUIT'S DECISION CONFLICTS WITH THE DECISIONS OF OTHER CIRCUITS.

Absent congressional authorization, regulations are presumed to have no "retroactive" effects. *Georgetown*, 488 U.S. at 500. The decision below broadens the scope of the presumption against retroactivity to include what Justice Scalia has referred to as "secondary retroactivity." *See Georgetown*, 488 U.S. at 219 (Scalia, J., concurring); *see Landgraf v. USI Film Prods*, 511 U.S. 244, 293 n.3 (1994) (Scalia, J., concurring) (no violation of presumption against retroactivity where law alters future legal effect of past transactions). Primary retroactivity occurs when a rule "alters the legal consequences of past events *as of the time of those events*"; secondary retroactivity, on the other hand, arises

when a rule merely changes the future consequences of past events as of the time the rule is enacted. John K. McNulty, *Corporations and the Intertemporal Conflict of Laws*, 55 Cal. L. Rev. 12, 58-59 (1967) (emphasis in original) (cited in *Georgetown*, 488 U.S. at 219 (Scalia, J., concurring)). Affecting a past transaction without congressional authorization is permissible; changing the past law is not. *Georgetown*, 488 U.S. at 220 (Scalia, J. concurring).

Under Judge Easterbrook's opinion, however, a rule that changes "today's financial consequences of an earlier transaction" has a retroactive effect that is impermissible absent express congressional authorization. App. 9a. This is directly contrary to circuits that hold that changing the future financial consequences of a past transaction is *not* the type of retroactivity requiring congressional authorization. *See, e.g., U.S. AirWaves, Inc. v. FCC*, 232 F.3d 227, 233 (D.C. Cir. 2000) (rule with secondary retroactivity valid so long as reasonable); *Nat'l Med. Enters., Inc. v. Sullivan*, 957 F.2d 664, 671 (9th Cir. 1992) (rule limiting the rate of return on a past investment is secondarily retroactive and subject only to a reasonableness test). The D.C. and Ninth Circuits have adopted Justice Scalia's reasoning, noting the distinction between primary and secondary retroactivity and concluding that only laws with primary retroactivity trigger the presumption that retroactive rules requires express congressional authorization. *See U.S. AirWaves*, 232 F.3d at 233; *Nat'l Med. Enters., Inc.*, 957 F.2d at 671. *See also FDIC v. Faulkner*, 991 F.2d 262, 266 (5th Cir. 1993) (noting distinction, but finding no need to apply it).

The distinction is important. As Justice Scalia has recognized, rules with secondary retroactivity are well within an agency's rulemaking authority – without any need for congressional authorization. *Georgetown*, 488 U.S. at 219-

220 (Scalia, J., concurring). A rule establishing new rates for Medicare reimbursement, for example, may be applied to payors who have entered long-term contracts negotiated in reliance on the old rates, so long as the rule is applied only to payments for future services. *Id.* at 220. Similarly, a rule that limits the future return allowed on an investment may be applied to investments made before the rule was promulgated, because changing the future consequences of a past transaction is "an entirely lawful consequence of much agency rulemaking." *Nat'l Med. Enters.*, 957 F.2d at 671.

The other circuits addressing the issue have thus all upheld rules with secondary retroactivity without express congressional authorization. *See, e.g., U.S. AirWaves,* 232 F.3d at 233 (rule with secondary retroactivity valid so long as reasonable); *Nat'l Med. Enters.*, 957 F.2d at 671 (upholding application of a regulation that "undeniably affected the *future* legal consequences of past transactions," but did not alter "the past legal consequences of past actions"). Indeed, the D.C. Circuit has repeatedly held that agency rules with such "secondary retroactivity" need only meet the reasonableness test required by the arbitrary and capricious standard of the Administrative Procedure Act. *See Independent Petroleum Ass'n of Am. v. DeWitt,* 279 F.3d 1036, 1039 (D.C. Cir. 2002) (applying reasonableness test to rule with secondary retroactivity); *U.S. AirWaves,* 232 F.3d at 233 (a secondarily retroactive rule "is valid only to the extent that it is reasonable"); *Bergerco Can. v. United States Treasury Dep't,* 129 F.3d 189, 192-93 (D.C. Cir. 1997) (explaining analysis); *DIRECTV, Inc. v. FCC,* 110 F.3d 816, 825-26 (D.C. Cir. 1997) (applying reasonableness test). This is a far cry from the Seventh Circuit's requirement of express congressional authorization.

There is no logical way to reconcile the split of authority created by the Seventh Circuit's decision below. A rule with merely secondary retroactivity will be subject to a much stricter standard in the Seventh Circuit than in the rest of the nation, making the validity and application of many regulations turn on which court hears the case.

II. THE DECISION BELOW IS INCONSISTENT WITH THIS COURT'S DECISION ON RETROACTIVITY.

In *Landgraf v. USI Film Products,* 511 U.S. 244 (1994), this Court instructed lower courts to determine if a law is "truly" or "genuinely" retroactive by looking at whether it creates new legal consequences for "events ***completed*** before its enactment." *Id.* at 270, 277, 279 (emphasis added). *See also id.* at 293 n.3 (Scalia, J., concurring) (explaining why the presumption against retroactivity is not violated by a law that alters the future effect of past transactions). The decision below, however, fails to distinguish between ongoing and completed events.

Judge Easterbrook's failure to appreciate the importance of this distinction is apparent in his conclusion that the parties' transaction was "no different, as an economic matter," than if petitioners had been paid a lump sum instead of an on-going royalty. App. 10a. First, as an economic matter, there is a significant difference between the two: providing for future royalty payments shifts to the seller the risk of various possible future events (not only changes in the law, but bankruptcy of the buyer, development of new technology, or other events that would make the 800 number more or less valuable). A rational negotiation of a lump-sum payment would have produced an amount lower than the

present value of the future royalty stream because it would have relieved the seller (respondents) of these risks.

Second, the *legal* difference between a lump-sum transaction and a royalty arrangement is critical. If respondents had been paid a lump sum before 1997, their transaction would have been completed before the rule's promulgation, and the law would have left the parties where it found them. But the arrangement here was *not* completed before the 1997 rule took effect. Because respondents chose future royalties over a lump sum, they must invoke the affirmative aid of the law in compelling a continuation of contractual performance that concededly violates current law.

III. THE DECISION BELOW CONFLICTS WITH THIS COURT'S DECISIONS FORBIDDING FEDERAL COURTS FROM ENFORCING CONTRACTS THAT VIOLATE PUBLIC POLICY.

This Court has long held that federal courts may not enforce contracts that violate law or public policy, even if the contracts were valid when made. *See, e.g., W.R. Grace & Co. v. Local Union 759*, 461 U.S. 757 (1983); *Hurd v. Hodge*, 334 U.S. 24 (1948); *Norman v. Baltimore & Ohio R.R.*, 294 U.S. 240, 307, 308, 311 (1935); *Louisville & Nashville R.R. v. Mottley*, 219 U.S. 467, 485 (1911). The reason is simple: enforcing a contract that violates public policy frustrates that policy, regardless of whether the contract was made before or after the adoption of the policy. *Norman*, 294 U.S. at 309-10 (holding gold clauses in pre-existing private contracts unenforceable after passage of congressional resolution declaring such clauses to be against public policy).

The issue, then, is not the validity of contract, but the power of the courts:

> The power of the federal courts to enforce the terms of private agreements is at all times exercised subject to the restrictions and limitations of the public policy of the United States as manifested in the Constitution, treaties, federal statutes, and applicable legal precedents. Where the enforcement of private agreements would be violative of that policy, it is the obligation of courts to refrain from such exertions of judicial power.

Hurd, 334 U.S. at 34-35. Thus, public policy can deprive a court of authority to enforce a private contract, even where the contract itself is perfectly legal. *Id.* (holding it violated public policy to use the power of the federal courts to enforce a private agreement not to sell a house to blacks, even where the private agreement was not itself illegal). Where the contract actually violates some public policy – even policies adopted after the contract was made – the courts lack the power to enforce it because enforcement would then itself violate public policy. *See W.R. Grace*, 461 U.S. at 766 (noting that if a contract "violates some explicit public policy, we are obliged to refrain from enforcing it"); *Norman*, 294 U.S. at 309-310.

Accordingly, this Court held in *Louisville & Nashville R.R. v. Mottley* that a contract is unenforceable, even though valid when made, if it would be illegal to enter into such a contract at the time enforcement is sought. *Mottley*, 219 U.S. at 485. In *Mottley*, a railroad company promised an injured railroad passenger free annual passes for life in exchange for a release of all claims against the railroad company arising

from the passenger's injuries. *Mottley*, 219 U.S. at 471-72. Some 30 years later, Congress enacted a statute making it illegal to give free annual passes. *Id.* at 472. The railroad company refused to continue to give the injured passenger free annual passes, and the passenger sued to enforce the contract. *Id.* This Court ruled that since the contract for free annual passes "would have been illegal if made after the passage of the commerce act, it cannot now be enforced against the railroad company, even though valid when made." *Id.* at 485.

Here, Jahn was promised ongoing royalties on the sale of flowers over the telephone number 1-800-FLOWERS in exchange for the sale of the number. App. 5a. Some 15 years later, the FCC promulgated a regulation making it illegal to pay a fee for the sale of a toll-free telephone number. 47 C.F.R. § 52.107; App. 5a. Jahn sued to enforce the contract, and the district court ruled that since the contract would have been illegal if entered after promulgation of the FCC's rule, it could not be enforced against petitioners, even if it was valid when made. App. 27a, 30a.

Enforcing the contract would require the court to exercise its power to compel payment for the sale of a toll-free telephone number. Public policy, however, expressly prohibits the establishment of any ownership interests in toll-free numbers, and compelling payment for the sale of a number establishes ownership interests in that number. *See FCC Letter to Joseph J. Weiss*, 13 F.C.C.R. 4122 (1997) (explaining that attempts "to negotiate the transfer of a toll free number for profit were contrary to the longstanding Commission policy prohibiting the establishment of ownership interests in toll free numbers").

Indeed, the FCC has made it clear that any attempt to profit from the sale of even a *single* toll-free number is contrary to public policy. *Id.*; 47 C.F.R. § 52.107(b) ("[T]he sale of a toll free number by a private entity for a fee, is contrary to the public interest ... and to the FCC's responsibility to promote the orderly use and allocation of toll free numbers."). Jahn's contract requires perpetual payments for the sale of a toll-free telephone number; enforcing that contract is just as contrary to public policy as the attempt to profit from the sale. *See id.*; App. 27a, 30a. Under this Court's decisions, the district court had an obligation to decline to enforce the contract. *Hurd*, 334 U.S. at 34-35; *see* App. 30a.

The Seventh Circuit, however, reversed the district court and directed further proceedings on Jahn's claim for enforcement of the contract. App. 11a. By reversing the summary judgment and allowing Jahn's claim to proceed, the Seventh Circuit completely departed from this Court's decisions in *Hurd, Mottley,* and *Norman*, without explaining or even acknowledging its departure. Certiorari should be granted to affirm the continuing validity of this Court's decisions.

CONCLUSION

For the reasons stated above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

WILLIAM M. CONLEY
Counsel of Record
SHARON MOLLMAN ELLIOTT
FOLEY & LARDNER
150 E. GILMAN STREET
POST OFFICE BOX 1497
MADISON, WI 53701
(608) 257-5035

July 10, 2002

Counsel for Petitioners

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

April 23, 2002

No. 01-2999

Before
Hon. JOEL M. FLAUM, Chief Judge
Hon. WILLIAM J. BAUER, Circuit Judge
Hon. FRANK H. EASTERBROOK, Circuit Judge

CURTIS P. JAHN and
CAPITOL WAREHOUSING CORPORATION,
Plaintiffs-Appellants,

v.

1-800-FLOWERS.COM, INC.,
FRESH INTELLECTUAL PROPERTIES, INC.
and 800-FLOWERS, INC.,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Wisconsin
No. 00-C-446-C
Barbara B. Crabb, *Chief Judge*

ORDER

Defendants-appellees filed a petition for rehearing and rehearing en banc on April 12, 2002. No judge in regular active service has requested a vote on the petition for rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 01-2999

Curtis P. Jahn and Capitol Warehousing Corporation,
Plaintiffs-Appellants,

v.

1-800-FLOWERS.com, Inc., Fresh Intellectual Properties, Inc., and 800-FLOWERS, Inc.,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Wisconsin
No. 00-C-446-C
Barbara B. Crabb, *Chief Judge*

Argued January 17, 2002 — Decided March 29, 2002

Before Flaum. *Chief Judge*, and Bauer and Easterbrook, *Circuit Judges*. Flaum, *Chief Judge*, concurring.

OPINION

Easterbrook, *Circuit Judge.*

When Madison Truck Brokers subscribed to an incoming-toll-free number in 1976, AT&T assigned it 800 356-9377 at random. Madison Truck Brokers and its successor Capitol Warehousing Corporation used the number in their transportation business until 1982, when they expanded into floral delivery. William Alexander thought that 800-FLOWERS would be the ideal toll-free number for a florist — and someone typing that sequence on a phone's keypad will reach 800 356-9377.

Alexander approached Curtis Jahn, the owner of Capitol Warehousing, with a proposal to test-market floral sales via the 800-FLOWERS number. Jahn and investors recruited by Alexander organized 800-Flowers, Inc., a Wisconsin corporation, to explore the idea and, if events justified, to run a national flowers-by-phone business. Advertisements in New Orleans produced enough calls to encourage further exploration. (The record does not reveal how the venture separated the flower-related calls from truck-related calls, for every call to that number reached Capitol Warehousing's office.) After an infusion of additional capital and resolution of litigation brought by another corporation that claimed trademark rights to "800-FLOWERS" (though the rival lacked the phone number to go with the idea), the business was launched nationwide. At Jahn's request, AT&T transferred the phone number to 800-Flowers (Wisconsin), which became the subscriber and paid all bills. In a move that he may now regret, Jahn took not only an equity stake in the new corporation but also a royalty interest in revenues derived from phone sales. Corporate reorganizations transferred the firm's assets to 800-Flowers (Texas) and later 800-Flowers

(New York), which is among the defendants. Jahn gave up his equity interest but retained his royalty (as restated by an agreement with 800-Flowers (Texas) in 1986, an agreement that contains a Texas choice-of-law clause).

In this suit under the diversity jurisdiction, Jahn accuses 800-Flowers (New York) and its parent corporation 1-800-Flowers.com, Inc. — a corporate name mixing Internet with phone symbols, packet-switched with circuit-switched networks — of failing to pay his full royalty under the 1986 agreement. Defendants responded that payment is illegal under a regulation forbidding the sale of phone numbers — and for good measure they added the inconsistent defense that they have paid Jahn every penny that the agreement requires. The district court concluded that the royalty interest reflects at least in part the value of the 800-FLOWERS number and constitutes a sale proscribed by the 1997 regulation, 47 C.F.R. §52.107(a), even though a stock interest of equivalent economic value would be lawful today. This aspect of the district court's ruling has not been contested on appeal. Next the district court concluded that it is unnecessary to decide whether the 1997 regulation may be applied retroactively. The ongoing *payment* is itself illegal, the judge held, and defendants are excused from further payment because Texas law treats illegality as a form of impossibility that constitutes a defense to non-performance. See *Centex Corp. v. Dalton*, 840 S.W.2d 952 (Tex. 1992).

Given the district court's uncontested finding that Jahn's royalty interest represents the sale of a telephone number, we may assume that the 1982 and 1986 transactions would violate federal law if implemented today. The governing regulation provides:

(a) As used in this section, hoarding is the acquisition by a toll free subscriber from a Responsible Organization of more toll free numbers than the toll free subscriber intends to use for the provision of toll free service. The definition of hoarding also includes number brokering, which is the selling of a toll free number by a private entity for a fee.

(1) Toll free subscribers shall not hoard toll free numbers.

(2) No person or entity shall acquire a toll free number for the purpose of selling the toll free number to another entity or to a person for a fee.

(3) Routing multiple toll free numbers to a single toll free subscriber will create a rebuttable presumption that the toll free subscriber is hoarding or brokering toll free numbers.

(b) The following provision shall be included in the Service Management System tariff and in the local exchange carriers' toll free database access tariffs:

[T]he Federal Communications Commission ("FCC") has concluded that hoarding, defined as the acquisition of more toll free numbers than one intends to use for the provision of toll free service, as well as the sale of a toll free number by a

> private entity for a fee, is contrary to the public interest in the conservation of the scarce toll free number resource and contrary to the FCC's responsibility to promote the orderly use and allocation of toll free numbers.

47 C.F.R. §52.107. Number "hoarding" is proscribed, and subsection (a) defines "hoarding" to include "number brokering", which includes "the selling of a toll free number by a private entity for a fee." As an independent matter it would be difficult to conceive of Capitol Warehousing's corporate mitosis, and the allocation of its toll-free number to one of the offspring, as an episode of either "number hoarding" or "number brokering", whether or not the original corporation's owner was paid for his assistance in the transaction. Capitol Warehousing did not tie up "more toll free numbers than the toll free subscriber intends to use for the provision of toll free service" or "acquire a toll free number *for the purpose of* selling the toll free number" (emphasis added).

The Federal Communications Commission has not made it clear whether *every* transfer for value is a form of "number brokering" even when the transfer does not entail any of the events listed in subsections (a)(1) through (a)(3); the regulation does not contain the word "all" and thus its scope is open to question. To say "A includes B" is not necessarily to say "all B is A." Many firms transfer their phone numbers to their successors (or to ventures spun off into subsidiaries) in order to preserve the good will and custom of the business. The regulation shows that phone numbers cannot be treated like Internet domain addresses, which regularly are sold outright for a fee, but it does not show that all transfers to new ventures are forbidden; it would

not make much sense to have numbers with economic value (such as 800-FLOWERS) perpetually assigned to businesses (such as transportation brokers) that cannot realize this value. Moving assets to higher and better uses is an important goal of any economic system. Drawing a line between these normal and lawful transactions and forbidden "hoarding" or "number brokering" would be a job for the FCC, not for the courts, at least as an initial matter. But we need not send this issue to the Commission under the doctrine of primary jurisdiction, because it is possible to resolve this case on the assumption that all sales are "number brokering".

The district court bypassed the question whether §52.107 proscribes sales that occurred before its adoption. For reasons explained presently, the answer matters — and it is a simple "no." Federal regulations do not, indeed cannot, apply retroactively unless Congress has authorized that step explicitly. See *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988). No statute authorizes the FCC to adopt regulations with retroactive effect, and §52.107 does not purport to affect transactions entered into before 1997. Defendants say that §52.107 just restates prior law, but this position is untenable. Relevant prior law, from the phone companies' tariffs, was that subscribers do not own telephone numbers assigned to them. This meant that the carriers could change numbers without liability to the subscribers. It did not mean that subscribers were forbidden to transact about whatever interests they enjoyed in the use of numbers currently assigned. Consider Internet domain names. These are rented by the year from administrators (one per top domain), yet there is a thriving market in these addresses. This is true of other leaseholds: a lessee does not own the premises but may transfer his possessory interest for whatever price the traffic will bear, unless the lease forbids assignments and subleases. A football team does not own its players but

may trade their contracts. And, as *University of Georgia v. Carroll*, 338 U.S. 586 (1950), holds, broadcast licenses may be sold despite the mantra that the airwaves are a public resource. If broadcast licenses may be sold even though they are not "property" of the licensees, then telephone numbers could be sold until 1997 even though they, too, are not the subscribers' property. Jahn could not have compelled AT&T to transfer the number to 800-Flowers (Wisconsin), but it proved willing to do so, and no rule of federal law in force at the time prevented the firm from compensating Jahn for his assistance in securing this transfer.

Thus we arrive at the question whether deferred payment for a lawful (because pre-1997) sale violates §52.107 — for, if it does, then Texas law gives 800-Flowers (New York) a defense. Yet nothing in §52.107 speaks to payment; the regulation concerns future sales, not compensation for older and thus lawful sales. That's what it means to say that the regulation is not retroactive. All "retroactivity" *could* mean for these parties would be a prohibition against future payments. (Surely defendants do not think that the regulation compels AT&T to restore 800 356-9377 to Capitol Warehousing, the original subscriber!) Changing today's financial consequences of an earlier transaction is the paradigm of retroactivity. See *Landgraf v. USI Film Products*, 511 U.S. 244 (1994). When Congress compelled mine operators to pay black lung benefits to miners who retired before the law's enactment, the Supreme Court treated this as classically retroactive legislation. See *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976). It did not say, as defendants here do, that a law is prospective when it rearranges wealth for the future; a wealth transfer that depends on events preceding the rule's adoption has a retroactive effect. Defendants insist that §52.107 transfers wealth from Jahn to themselves, on account of events that

occurred in 1982 and 1986. That would be an instance of retroactivity; and as §52.107 is *not* retroactive, it also does not affect the royalty. (Nor does any other rule of federal law do so. Defendants err in supposing that there is a rule against perpetual royalties. See *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979).)

A royalty is a risk-sharing agreement. Instead of paying Jahn up front the estimated value of the phone number, the investors who established 800-Flowers (Wisconsin) and its successors divided the risk with Jahn, so that he would be paid only to the extent the new business succeeded. Suppose they had done things otherwise — paying Jahn a lump sum and dividing the risk among investors who financed that payment. Any attempt to force Jahn to disgorge what he received in 1982 or 1986 would be retroactive. Yet this is no different, as an economic matter, from refusing to make ongoing payments. Suppose that Jahn had manufactured his own lump-sum payment by borrowing against the value of the royalty. A bank could have lent Jahn $1 million (say) in 1986, taking the royalty agreement as security for repayment. The effect on such a lender of losing its security because of a 1997 regulation would be visibly retroactive. So too if 800-Flowers (Wisconsin) had paid Jahn $1 million cash, borrowing the money from bondholders who were promised repayment out of the phone number's future value. Defendants could not have used the 1997 regulation as a reason to stop repaying their bondholders. Or consider yet another example: suppose that Texas were to vote to go dry on January 1, 2003, and ban all imports of liquor, as §2 of the twenty-first amendment permits. During December 2002 a vintner delivers 1,000 cases of its best cabernet sauvignon to a merchant in Texas, on credit. January 1 arrives; no new sales could be made; would the buyer be free to ignore the debt for the wine already received? Surely Texas would not

permit such a step, which would differ but little from theft. If the buyer of wine must pay even after new sales have been forbidden, then the buyer of a phone number must pay too.

Defendants have other arguments that the district court did not consider. We leave these to be sorted out on remand.

REVERSED AND REMANDED

CONCUR

Flaum, *Chief Judge,* concurring. I join the panel's opinion and only comment separately to underscore what I understand to be the holding of this case. The circumstances presented in this appeal are unique (a toll-free telephone number was effectively sold, in exchange for the payment of royalties, prior to the time when such transfers became illegal). I do not consider our decision today to authorize the sale, brokering or hoarding of toll-free numbers, as the FCC has clearly spoken on this issue.

A true copy:

Teste:

_____

Clerk of the United States Court of Appeals for the Seventh Circuit

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

00-C-446-C

CURTIS P. JAHN and
CAPITOL WAREHOUSING CORPORATION,
Plaintiffs,

v.

1-800-FLOWERS.COM, INC.,
FRESH INTELLECTUAL PROPERTIES, INC.
and 800-FLOWERS, INC.,

Defendants.

OPINION AND ORDER

This is a civil action for declaratory, injunctive and monetary relief in which plaintiffs Curtis Jahn and Capitol Warehousing Corporation contend that defendants 1-800-FLOWERS. COM, Inc., Fresh Intellectual Properties, Inc. and 800-FLOWERS, Inc. breached a contract to pay plaintiffs a perpetual royalty on certain floral sales in return for undertakings by plaintiffs that included assignment of the toll free phone number 1-800-FLOWERS. Plaintiffs also seek a declaration of defendants' obligations under the contract. Jurisdiction is present under 28 U.S.C. §1332. (Plaintiffs are Wisconsin citizens; defendants are citizens of either New York or Delaware; and the dispute involves more than $75,000.)

Presently before the court is defendants' motion for summary judgment. Defendants contend that the contract is unenforceable because regulations prohibit the sale of an 800 number; enforcement of a perpetual royalty is contrary to public policy; 800-FLOWERS, Inc. has fulfilled its obligations under the contract; the lawsuit is barred by the doctrine of laches; and a portion of plaintiffs' claims is barred by the statute of limitations. Defendants contend also that defendants 800-FLOWERS.COM and Fresh Intellectual Properties are not proper parties to this action. I conclude that the royalty clause of the contract is unenforceable because it requires payment for an act prohibited by federal regulation. Defendants' motion for summary judgment will be granted. It is unnecessary to address the other grounds for defendants' motion.

From the findings of fact proposed by the parties, I find that the following are material and not disputed.

UNDISPUTED FACTS

A. Parties

Plaintiff Capitol Warehousing is a warehousing and trucking business based in Windsor, Wisconsin. Plaintiff Curt Jahn founded Capitol Warehousing in 1978 and is Capitol Warehousing's president, chief executive officer and sole shareholder.

Defendants 800-FLOWERS, Inc. and Fresh Intellectual Properties are separately incorporated subsidiaries of defendant 1-800-FLOWERS.com, Inc. Defendant 800-FLOWERS, Inc. is a floral and gift delivery service that is incorporated in New York. Defendant Fresh Intellectual Properties holds the intellectual properties of the other

companies.

B. Assignment of the FLOWERS Number to Jahn

In 1976, AT&T assigned the telephone number 1-800-356-9377 randomly to Madison Truck Brokers, a trucking brokerage company owned and operated by plaintiff Jahn. The telephone keypad letters associated with that number spell out "1-800-FLOWERS." Madison Truck Brokers was not engaged in any floral-related business and Jahn did not request that particular number. After Jahn formed plaintiff Capitol Warehousing, he transferred the FLOWERS number to that company. Capitol Warehousing continued to use the FLOWERS number in the operation of its warehousing and trucking business. Jahn's contract with the telephone company for use of the FLOWERS number was subject to conditions and tariffs imposed on 800 number service. Jahn knew he had no ownership interest or proprietary right in the FLOWERS number when it was assigned to his company.

C. The Creation of 800-FLOWERS

In the early 1980s, William Alexander developed the concept of using the FLOWERS number for a floral-delivery business. Granville Semmes and David Snow approached plaintiffs with the idea of using the FLOWERS number to take floral orders over the phone in approximately 1981. Jahn, Semmes and Snow did a trial experiment in 1982 and then Jahn asked Alexander to join them. Semmes and Snow had formed a corporation in Louisiana called 800-FLOWERS (La.). Jahn formed 800-FLOWERS, Inc. (Wis.) with the intention of issuing stock to investors. (800-FLOWERS, Inc. (Wis.) is not the same corporation as defendant 800-FLOWERS, Inc., a New York corporation.)

In 1982, Semmes, Snow and Jahn began to test market the 800-FLOWERS concept in New Orleans. Before the test market experiment, neither plaintiff had any experience in the floral industry. Semmes and Snow were engaged in the advertising business and handled advertising and marketing for the business in New Orleans. They secured television advertising slots for customers to call 1-800-FLOWERS for delivery of floral gifts. Customer calls placed in New Orleans to the FLOWERS number were received by 800-FLOWERS, Inc. (Wis.) employees at Capitol Warehousing's Wisconsin offices, who sent the orders back to a New Orleans florist for delivery. Jahn's primary duty was to supervise the two to four telephone operators who processed the orders called in to Capitol Warehousing's offices. Jahn's financial contribution to 800-FLOWERS, Inc. (Wis.)'s business operations was minimal. Jahn provided the office, set up files, created forms and contributed to the development of the 800-FLOWERS business but made no monetary outlay for the test marketing. Semmes and Snow paid all expenses for the test marketing project and compensated Jahn for floral-order calls placed to the FLOWERS number, which Jahn continued to use for Capitol Warehousing's business. It was anticipated that if the test market was a success, Jahn, Snow and Semmes would engage in a business transaction for the sale of flowers by telephone.

The test marketing period was short-lived because a Madison, Wisconsin-based florist, Felly's Flowers, brought suit against plaintiffs, Snow and others for trademark infringement in August 1982. Later, 800-FLOWERS, Inc. (Wis.) was added as a defendant. Felly's had registered the trademark "Dial 1-800-FLOWERS" sometime in the 1970s, before the FLOWERS number had been issued. Because 800-FLOWERS, Inc. (Wis.) was unable to pay for the defense of Felly's suit, Alexander brought in new, Texas-based

investors, James Poage and John Davis, to finance the litigation. The federal court dismissed Felly's complaint. Felly's appealed but the litigation settled in the spring of 1984. In exchange for funding the lawsuit, Poage and Davis received an option to purchase a majority interest in the business.

D. The 1982 Initial Agreement and Transfer of the FLOWERS Number

On May 20, 1982, on behalf of Capitol Warehousing, Jahn executed an "Agreement to Release Telephone Number," transferring the FLOWERS number to 800-FLOWERS, Inc. (Wis.) and "releasing any claim to the use of this telephone number now or at any future date." On May 20, 1982, 800-FLOWERS, Inc. (Wis.) agreed to assume all outstanding charges, billed and unbilled, for the FLOWERS number. These documents were filed with AT&T and accepted by AT&T. Bills for use of the telephone number from June 1, 1982 to 1984 were submitted to 800-FLOWERS, Inc. (Wis.). No money or other consideration was paid by 800-FLOWERS, Inc. (Wis.) or anyone else on May 20, 1982 to plaintiffs in return for the assignment of the telephone number. Jahn controlled 800-FLOWERS (Wis.) until late September or early October 1982, when stock was issued.

The agreement among Semmes, Snow, Jahn and Alexander to fund the defense of the Felly's lawsuit included the subsequent operation of a business plan involving telemarketing flowers nationwide. Pursuant to this agreement, Jahn executed a Consent Resolution of Incorporator adopting the Restated Articles of Incorporation on September 27, 1982. The Restated Articles of Incorporation were signed by plaintiffs on September 27, 1982. On that day, plaintiffs

executed a bill of sale acknowledging that they had transferred the FLOWERS number to 800-FLOWERS, Inc. (Wis.). The bill of sale was needed to document the May 1982 assignment of the number for the corporate records. On September 28, 1982, Alexander subscribed to 34,085 shares of Class A common stock in return for $25,000 to be used in connection with the defense of the litigation. On September 28, 1982, pursuant to the agreement of the parties, Semmes and Snow each subscribed to 3,652.5 shares of Class A common stock; no consideration is recognized in the subscription. On September 28, 1982, plaintiffs subscribed to a total of 7,305 shares of Class B common stock. The agreement for subscription provides that the shares shall be distributed promptly upon the corporation's receipt of a bill of sale or such other document of assignment as the attorneys for the corporation might request to evidence the assignment of all right, title or interest to the FLOWERS number.

On October 2, 1982, plaintiffs entered into an agreement with 800-FLOWERS, Inc. (Wis.) providing for the payment of royalties to plaintiffs and providing that 70% of the stock would be issued to Alexander, 7.5% would be issued to Semmes, 7.5% would be issued to Snow and 15% would be issued to plaintiffs. By the terms of the agreement, Jahn gave up control of 800-FLOWERS, Inc. (Wis.), which was the subscriber to the FLOWERS number, and the parties recognized his participation in the business, including the prior assignment and transfer of the telephone number to 800-FLOWERS, Inc.

The October 2, 1982 agreement was intended to "evidence the terms" of "the consideration to be received by Jahn and Capitol for and as a result of their assignment of [the] FLOWERS [number] to the Corporation." Under the agreement, Jahn received a defined, quarterly royalty on 800-

FLOWERS, Inc. (Wis.)'s future income in exchange for the transfer and use of the FLOWERS number. The royalty was not tied to Jahn's employment with 800-FLOWERS or to any stock he might receive in the company. The agreement was prepared pursuant to "developing and marketing a business and system which employs and incorporates [the] FLOWERS [number] for the purpose of soliciting and receiving orders for and affecting the delivery of floral products through a telephone brokerage system or similar device" and recognized that Jahn had previously transferred the number to the corporation and should receive consideration for that transfer. The initial agreement states that Jahn's right to a royalty was perpetual and would be passed on to his heirs. Although 800-FLOWERS, Inc. (Wis.) was allowed to license the use of the FLOWERS number to other entities, any assignee was required to assume the perpetual royalty obligation. Under the agreement, if an assignee defaulted on its royalty obligations the assignee would forfeit its interest in the FLOWERS number and the number would revert to 800-FLOWERS, Inc. (Wis.).

The October 2, 1982 agreement was one part of the agreement among Semmes, Snow, Alexander and Jahn to form a business and share in its profits. Alexander would not have agreed to the royalty agreement had he not received 70% control. By document dated October 3, 1982, Davis and Poage, doing business as DP Joint Venture, agreed to provide funds for the defense of the litigation in return for an option to enter into a joint venture with 800-FLOWERS, Inc. whereby DP Joint Venture would receive 85% of the net profits initially and 70% of the net profits later. Jahn, Alexander, Semmes, Snow, Griffin, Davis and Poage all knew that the companies they formed did not have an ownership interest in the FLOWERS number and that the number could be transferred or assigned from one customer

to another.

In 1984,800-FLOWERS, Inc. (Wis.) was dissolved and its assets were transferred to 800-FLOWERS, Inc. (Texas).

F. The 1986 Amended Agreement

800-FLOWERS, Inc. (Texas) continued to struggle financially after Poage and Davis took over the company and moved it to Texas. In a 1985 letter to Jahn, 800-FLOWERS' new president wrote that "cash is an extremely tight commodity... [and a]s a result we have reduced the organization by 30%. By 1986, the company was in "desperate straits" financially.

In an effort to save the company, a successful florist based in New York, James McCann, proposed that Poage and he acquire a controlling interest in 800-FLOWERS, Inc. (Texas), with McCann managing the company's operations. McCann understood that the broad nature of Jahn's royalty under the initial agreement had been an impediment to previous efforts to sell the company. Among McCann's and Poage's requirements for additional investment in the company was that Jahn's royalty be narrowed and more clearly defined and that McCann's existing businesses be excluded from the royalty.

In order to facilitate McCann's acquisition of the company, Poage was charged with negotiating a new royalty agreement with Jahn. On October 10, 1986, Jahn and his attorney, A. J. Griffin, III, met with Poage in Madison, Wisconsin, at which time Poage presented them with a draft of the amended agreement. Jahn and Griffin read the amended agreement and Jahn signed it in Griffin's presence. The

amended agreement narrowed the sources of revenue to which Jahn's royalty would apply. The amended agreement provides, "This Agreement shall be governed by and interpreted, construed and enforced in accordance with the laws of the State of Texas." The amended agreement states,

> WHEREAS, [plaintiffs] have heretofore transferred and assigned to MADISON VENTURE, a joint venture comprised of 800 Flowers, Inc., a Wisconsin corporation, and DAVIS POAGE VENTURE, INC., a Texas corporation, which subsequently assigned their entire right, title and interest in and to [the FLOWERS number];
>
> WHEREAS, all of the right, tide and interest of said MADISON VENTURE in and to the [FLOWERS] Number was subsequently and eventually acquired by [800-FLOWERS, Inc. (Texas)]; and
>
> WHEREAS, the parties hereto desire to amend and restate in its entirety [the initial agreement].

The amended agreement contains an integration clause disavowing any earlier representations or agreements of the parties.

On June 21, 1996, defendant 1-800-FLOWERS.COM, Inc. (then known as 1-800-FLOWERS, Inc.) assumed all the obligations of 800-FLOWERS, Inc.. (Texas). On July 1, 1996, defendant 800-FLOWERS, Inc. (New York) assumed all the obligations of 800-FLOWERS, Inc. (Texas).

G. Toll Free Numbers

The Federal Communications Commission is not involved in the day-to-day allocation of toll free numbers but instead leaves the mechanics of the actual allocation of numbers to the industry. All toll free numbers are stored in a single computerized database, the System Management System (SMS/800). Spare toll free numbers are assigned to subscribers on a first-come, first-served basis. Toll free service providers must be certified by the database administrator as "responsible organizations."

The telephone industry establishes guidelines and files tariffs for toll free number service in compliance with the Federal Communications Commission's requirements. The tariffs filed with the commission provide specifically that subscribers have no "proprietary interest in any given 800 number." The 800 Industry Tariffs currently on file with the Federal Communications Commission provide that "[a]ll entities (e.g. Resp[onsible] Org[anization]s, subscribers, service providers) are prohibited from selling, brokering, bartering and releasing for a fee (or otherwise) any 800 number" and "[t]oll free numbers are not to be treated as commodities which can be bought or sold, and no individual or entity is granted a proprietary interest in any Toll Free number assigned." AT&T's 1984 tariff §2.1.7 reads, "nothing herein or elsewhere in this tariff shall give any customer, assignee, or transferee any interest or proprietary right in any given AT&T 800 service telephone number." The 1993 Bell Operating Companies' tariff includes the above language and also states, "All entities (e.g. Resp[onsible] Org[anization]s, subscribers, service providers), are prohibited from selling, brokering, bartering, and releasing for a fee (or otherwise) any 800 number."

Telephone numbers used in the operation of a business have a value and that value is recognized in the price of the business when it is transferred either by asset sale or stock sale.

Jahn has received more than $1 million in royalties under the initial and amended agreements.

OPINION

Defendants contend that the amended agreement should not be enforced because (1) plaintiffs had no property interest in the FLOWERS number to sell; (2) payment of a royalty interest for transfer of an 800 number is prohibited by regulation; and (3) enforcement is outweighed by public policy considerations. Plaintiffs contend that the royalty payment was not made in return for bartering, brokering or selling the FLOWERS number but instead was made in return for control of 800-FLOWERS and in recognition of the facts that Jahn had transferred the number to the corporation previously and that the number had value to the business.

A. FCC Rules Against Sale of Toll Free Numbers

The Federal Communications Commission has exclusive jurisdiction over those portions of the North American numbering plan that pertain to the United States. *See* 47 U.S.C. § 251 (e) (Supp. 2001). The law today is clear: "Toll free subscribers shall not hoard toll free numbers." 47 C.F.R. §52.107(a)(1). "The definition of hoarding ... includes number brokering, which is the selling of a toll free number by a private entity for a fee." 47 C.F.R. §52.107(a) (promulgated in April 1997). In its Second Report and Order discussing the 1997 amendments to 47 C.F.R. part 52, the Federal Communications Commission "f[ou]nd that there is

a 'legitimate governmental interest or rational basis' for declaring that toll free numbers are a public resource and that we must ensure that telephone numbers are allocated efficiently and fairly." Second Report and Order, 12 F.C.C.R. 11,162, at ¶ 32. In addition, the commission "f[ou]nd that number brokering, which is the selling of numbers by private entities for a fee, is not in the public interest. Brokering provides motivation for hoarding and therefore results in quicker exhaustion of the current [service access code] and interferes with the orderly allocation of numbering resources." *Id.* at ¶ 38.

Plaintiffs contend that the Federal Communication Commission's statements about number brokering are not relevant to this case because "[t]he FCC's primary concern was with the practice of private entities in accumulating quantities of toll-free numbers and attempting to sell them in ways that would quicken the decline of the number pool." Plts.' Br., dkt. #55, at 6. Be that as it may, the commission did not place any limits on its conclusion that number brokering is not in the public interest. Instead, it stated that toll free subscribers that brokered numbers would be subject to penalties.

The commission has addressed specific instances involving the sale of a toll free number. *See. e.g.*, Federal Communications Commission Letter to Joseph J. Weiss, DA 97-1247, 1997 WL 321717, 13 F.C.C.R. 4122 (Jun. 13, 1997) (finding that "TWC [Communications'] actions in attempting to negotiate the transfer of a toll free number for profit were contrary to the longstanding Commission policy prohibiting the establishment of ownership interests in toll free numbers."). In *Patients Plus, Inc. v. Long Distance Telecommuincations, Service, Inc.*, DA97-1831, 1997 WL 527886, 13 F.C.C.R. 5827 (Aug. 25, 1997), the commission

addressed Patients Plus's complaint that Long Distance Telecommunications Service withheld assignment of the toll free telephone number 1-800-JUSTICE after Patients Plus refused to pay $200,000 for it. The commission noted that the complaint was essentially a contract dispute between two parties whose efforts to undertake a joint venture were unsuccessful and found that Patients Plus had failed to meet its burden of proof. *Id.* at ¶ 19. Specifically, Patients Plus failed to prove that Long Distance Telecommunications had demanded payment for the number. *Id.* at ¶ 34. In response to the defendants' argument that the commission did not have rules proscribing the warehousing of 800 numbers at any time relevant to the complaint, the commission stated, "[a]lthough some of the[] policies [prohibiting the warehousing, hoarding and brokering of toll free numbers] may have only recently been enunciated by the Commission, they reflect long-standing Commission policy that toll-free telephone numbers are a public resource that is not the property of either the carrier or the subscriber. Accordingly, we are not restricted from finding the alleged conduct to be an unreasonable practice in violation of the Commission rules merely because it occurred prior to the recent rulemaking proceeding." *Id.* at ¶ 37. Because the commission had already determined that Patients Plus had failed to prove that the defendants demanded an unreasonable charge for assignment of the number, the case does not test the commission's willingness to apply the anti-brokering rules to contracts entered into before the rules were promulgated. Plaintiffs suggest that the commission's use in *Patients Plus* "of the phrase 'unreasonable charge' shows that the mere fact that consideration is paid for the transfer of a toll free number does not make the transfer contrary to public interest." Plts.' Br., dkt. #55, at 7 n.2. It is more likely the commission used the term "unreasonable" because the claim in that case was brought under 47 U.S.C. §201(b), which prohibits unjust or unreasonable "charges,

practices, classifications, and regulations for and in connection with [wire and radio] communication service." I decline to read into the commission's language an interpretation that a reasonable charge for assignment of the number would have been lawful under the commission's policy against number brokering.

B. Did Plaintiffs Sell the FLOWERS Number?

As the undisputed facts show, plaintiffs' royalty was paid as consideration for plaintiffs' transfer of the FLOWERS number to 800-FLOWERS, Inc. (Wis.), and is therefore a payment for transfer of the number. Although plaintiffs transferred the FLOWERS number to 800-FLOWERS, Inc. (Wis.) in May 1982 and executed a bill of sale stating that the number had been assigned to 800-FLOWERS, Inc. (Wis.) in September 1982, Jahn controlled 800-FLOWERS (Wis.) until stock was issued in October 1982. The initial agreement, entered October 2, 1982, states,

> WHEREAS [plaintiffs] have been the joint owners of all right, title and interest in and to [the FLOWERS number] . . . WHEREAS, the parties have agreed as to the consideration to be received by [plaintiffs] for and as a result of their assignment of [the] FLOWERS [number] to the Corporation and desire to evidence the terms of such agreement herein, [800-FLOWERS, Inc. will pay Jahn a perpetual royalty and issue stock.]

Jahn Dep., dkt. #31, Ex. 6 at J02049. The terms of the agreement indicate that Jahn was paid a royalty at least in part as consideration for his assignment of the FLOWERS number to 800-FLOWERS. The other terms of the agreement for

which the royalty might be consideration are the authorization of two classes of capital stock in 800-FLOWERS, Inc. Even if part of the royalty is for plaintiff Jahn's contribution of time or Jahn's giving up control of the corporation, the undisputed facts show that part of the royalty was paid in return for the assignment of the FLOWERS number. Such an assignment of the phone number in exchange for money is a sale of the number.

Plaintiffs state that before the initial agreement was signed, "Jahn had control of 800-FLOWERS, Inc. and believed he was entitled to compensation different from that received by mere ownership of stock in the corporation." Plts.' Br., dkt. #55, at 4. Because the FLOWERS number was the only real asset of 800-FLOWERS, Inc. (Wis.) that Jahn could lose by giving up control of the corporation, this statement amounts to a concession by Jahn that the royalty clause of the agreement was in exchange for his assignment of the FLOWERS number to the project. Jahn had no experience in the floral industry or any particular skill that would have justified compensating him with more than stock. Plaintiffs argue that "[t]he 1982 creation of a business plan was not a charade. It was a legitimate conscientious effort by four men to create a viable business entity while recognizing the value that each brought to the table." *Id.* at 5. The creation of a business plan does not appear to have been a charade. However, the only thing of value that plaintiff Jahn "brought to the table" was the FLOWERS number. Plaintiffs' argument that "Jahn gave up control in the *corporation* in return for a royalty," *id.* (emphasis in original) is an exercise in semantics; the only thing in the corporation he could relinquish was the FLOWERS number.

This conclusion is not affected by the amended agreement between plaintiffs and 800-FLOWERS, Inc.

(Texas) that has been in effect since October 10, 1986. The initial agreement was a sale of the FLOWERS number for a perpetual royalty; the 1986 amendment changed the description of the royalty but did not change the reason for its payment. Because the royalty is an ongoing payment, owed as long as 800-FLOWERS sells flower products over the FLOWERS number, plaintiffs continue to profit from the assignment of the number. The ongoing payment violates Federal Communications Commission policy and 47 C.F.R. §52.107(a)'s prohibition against selling toll free numbers for a fee.

C. Effect of Regulations on Amended Agreement

Because I have determined that plaintiffs sold a toll free number for a fee, the initial and amended agreements would have been illegal had they been entered into after the 1997 FCC rulings. The legality of assigning a toll free number in exchange for money in 1982 and 1986 is not as clear. However, it is not necessary to reach that question. Neither side focuses on the relevant issue: assuming the amended agreement was valid when it was entered into in 1986, does the 1997 regulation render it unenforceable? Defendants contend that it was illegal to sell the FLOWERS number in the 1980s and alternatively that the 1997 FCC regulation applies retroactively. Plaintiffs also focus on retroactivity and cite a Wisconsin case from 1920 for the proposition that "a contract valid when made cannot be rendered invalid even by legislative action." Plts.' Br., dkt. *#55,* at 9 (quoting *Sheffield-King Milling Co. v. Jacobs*, 170 Wis. 389, 400-401, 175 N.W. 796, 801 (1920)). That statement is not an accurate reflection of the current state of the law.

"[W]here the contract was originally legal, but because of... a change in the law, performance of the acts prescribed in the contract by one of the parties has become illegal, any subsequent performance of such acts is against public policy and the party who has undertaken to perform them is excused from doing so." 8 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts* §19:35 at 365-66 (4th ed. 1998). "Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary." *Restatement (Second) of Contracts* §261 (1981). The non-occurrence of a change in regulation is a basic assumption on which any contract is made. *See Restatement (Second) of Contracts* §264.

The amended agreement provides that it will be interpreted and enforced in accordance with the laws of the state of Texas. The Supreme Court of Texas has recognized the doctrine of impossibility because of illegality. In *Centex Corporation v. Dalton*, 840 S.W.2d 952 (Tex. 1992), Centex contracted to pay Dalton a consulting fee over three years if Centex was successful in acquiring four central Texas thrift organizations. After Centex acquired the thrift organizations, the Federal Home Loan Bank Board approved the acquisition but conditioned the approval on a prohibition against the thrift organizations' direct or indirect payment of finder's fees. *Id.* at 953. The court concluded that because Congress had given the Bank Board power to regulate the acquisition and control of federally-insured thrifts by savings and loan holding companies, the board's prohibition made it illegal for Centex to perform under the letter agreement. *Id.* at 954. The court quoted the *Restatement (Second) of Contracts* §§261 and 264

in holding that Centex was excused from performance by the doctrine of impossibility. *Id.* The court's reasoning applies to this case. After the enactment of 47 C.F.R. §52.107(a)(1) in 1997, it became illegal for defendant 800-FLOWERS, Inc. to continue paying money for the assignment to it of the FLOWERS number, excusing defendant from performance by the doctrine of impossibility.

In *Centex*, the court of appeals had reasoned that because Centex's obligation to pay Dalton arose when the letter agreement was signed and before the Bank Board adopted its prohibition, the prohibition did not apply to the letter agreement and did not bar Centex from paying Dalton his fees. *Id.* at 955. The Supreme Court of Texas disagreed, concluding that because the letter agreement was premised on a condition precedent, Dalton's right to enforce it could not accrue until the Bank Board approved the acquisition. When the Bank Board prohibited the payment of finder's fees as a condition of its approval, it invalidated the letter agreement. Dalton's right to enforce the letter agreement never accrued. *Id.* at 956. Although in this case the condition precedent was not as direct, it is implicit in the performance of any contract that the performance be legal at the time it is performed. *See In re Kasschau*, 11 S.W.3d 305, 312 (Tex. App. 1999) (quoting *Lewis v. Davis*, 199 S.W.2d 146, 148-49 (Tex. 1947)) ("'A contract to do a thing which cannot be performed without violation of the law' violates public policy and is void.").

To plaintiffs' contention that it would be inequitable to relieve defendants of the duty of paying the royalty because defendants have already been assigned the phone number and have gotten the value they wanted from the bargain, there is a straightforward response. "[W]here illegality is raised it is the interest of the public, rather than the equitable standing of

the parties or either of them, that is of importance. The defense of illegality is not allowed because the party raising it is entitled to any consideration, but rather because principles of public policy demand that the defense be raised to promote the public interest." 6 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts* §12:4 at 32-35 (4th ed. 1995). "The rationale behind the rule [voiding contracts the performance of which would be illegal] is not to protect or punish either party to the contract, but to benefit and protect the public." *Kasschau*, 11 S.W.3d at 312.

Defendants are not seeking disgorgement of any royalties they have paid to date and I am not applying the Federal Communications Commission policy retroactively to the amended agreement. Therefore, it is not necessary to address plaintiffs' argument that retroactive application would violate their due process rights under the Fifth Amendment. Plaintiffs contend that because the Federal Communications Commission has exclusive jurisdiction in this area and is the expert in interpreting the scope of its policy and in penalizing violations, the commission and not this court should evaluate defendants' claim that the amended agreement is unenforceable. The policy against selling toll free numbers is codified in 47 C.F.R. §52.107; this court has authority to decline to enforce a contract that violates federal regulations. I will not order any additional penalty for the violation, making it unnecessary to address the limits of this court's authority. The conclusion that the royalty provision of the amended agreement is unenforceable dictates the entry of summary judgment for all defendants.

ORDER

IT IS ORDERED that the motion for summary judgment brought by defendants 1-800-FLOWERS.COM,

Inc., Fresh Intellectual Properties, Inc. and 800-FLOWERS, Inc. is GRANTED. The clerk of court is directed to enter judgment for defendants and to close this case.

Entered this 23rd day of July, 2001.

BY THE COURT:

/s/_____
BARBARA B. CRABB
District Judge

Supreme Court, U.S.
FILED
AUG 13 2002
OFFICE OF THE CLERK

No. 02-71

In The

Supreme Court of the United States

1-800-FLOWERS.COM, INCORPORATED,
FRESH INTELLECTUAL PROPERTIES,
INCORPORATED, AND
800-FLOWERS, INCORPORATED,

Petitioners,

v.

CURTIS P. JAHN AND
CAPITOL WAREHOUSING CORPORATION,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

EARL H. MUNSON
Counsel of Record
CATHERINE M. ROTTIER
BOARDMAN, SUHR, CURRY
& FIELD LLP
1 South Pinckney Street, Suite 410
P.O. Box 927
Madison, Wisconsin 53701-0927
(608) 257-9521
Counsel for Respondents

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Does an FCC public policy to prevent hoarding of a scarce supply of toll-free telephone numbers have any bearing on the enforcement of the private contract at issue in this case?

2. If a 1997 FCC regulation is used to impair contractual obligations arising from private transactions legally entered into in the 1980's, are the rules against retroactive agency action violated?

RULE 29.6 NOTATION

Capitol Warehousing Corporation is privately held and no publicly-held company owns stock in the corporation.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 29.6 NOTATION	ii
ADDITIONAL REGULATION INVOLVED	1
REASONS FOR DENYING THE WRIT	2
I. THE UNIQUE BACKGROUND OF THIS CASE MAKES IT INAPPROPRIATE FOR CERTIORARI REVIEW	3
II. PETITIONERS' PUBLIC POLICY ARGUMENT IS WITHOUT MERIT	5
III. CERTIORARI REVIEW IS INAPPROPRIATE BECAUSE PETITIONERS DID NOT DEVELOP AN ADEQUATE RECORD BELOW ON THE PRIMARY VERSUS SECONDARY RETROACTIVITY ISSUE ON WHICH THEY PREDICATE THEIR REQUEST FOR A WRIT	6
IV. PETITIONERS HAVE NOT SHOWN A CONFLICT BETWEEN THE DECISION BELOW AND THE DECISIONS OF OTHER COURTS OF APPEALS ON "THE SAME IMPORTANT MATTER"	7
V. USE OF THE 1997 FCC REGULATION TO IMPAIR CONTRACTUAL OBLIGATIONS ARISING FROM PRIVATE TRANSACTIONS LEGALLY ENTERED INTO IN THE 1980's WOULD VIOLATE THE RULES AGAINST RETROACTIVE AGENCY ACTION	9
CONCLUSION	14

TABLE OF AUTHORITIES

Page

CASES:

Bergerco Canada v. U.S. Treasury Dept., 129 F.3d 189 (D.C. Cir. 1997) 7

Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988) 6, 8, 11, 12, 13

Direct TV, Inc. v. Federal Communications Comm., 110 F.3d 816 (D.C. Cir. 1997) 7

Federal Deposit Ins. Corp. v. D.L. Faulkner, 991 F.2d 262 (5th Cir. 1993) 7

Landgraf v. USI Film Products, 511 U.S. 244 (1994) 6, 8, 9, 11, 12

National Ass'n of Regulatory Util. Com'rs v. F.C.C., 746 F.2d 1492 (D.C. Cir. 1984) 3

Society for Propagation of the Gospel v. Wheeler, 22 F. Cas. 756 (1814) 12

United States v. Mississippi Valley Generating Co., 364 U.S. 520 (1961) 13

STATUTES AND REGULATIONS:

47 C.F.R. §52.101 ..... 1, 10

47 C.F.R. §52.107 ..... *passim*

ADMINISTRATIVE ORDERS:

Resale and Shared Use, 83 F.C.C. 2d 167 (1980) 3

Second Report & Order and Further Notice of Proposed Rulemaking, In the Matter of Toll-Free Service Access Codes, CC Docket No. 95-155, 12 FCC Rcd 11, 162 (4/11/97) 4

TABLE OF AUTHORITIES – Continued

Page

Toll Free Service Access Codes, Notice of Proposed Rulemaking, CC Docket No. 95-155, FCC No. 95-419 (10/5/95) 4

RULES CITED:

Rule 10(a) of the Rules of the Supreme Court of the United States 2

ADDITIONAL REGULATION INVOLVED

47 C.F.R. §52.101: General Definitions.

As used in this part:

(a) *Number Administration and Service Center ("NASC").* The entity that provides user support for the Service Management System database and administers the Service Management System database on a day-to-day basis.

(b) *Responsible Organization ("RespOrg").* The entity chosen by a toll free subscriber to manage and administer the appropriate records in the toll free Service Management System for the toll free subscriber.

(c) *Service Control Points.* The regional databases in the toll free network.

(d) *Service Management System Database ("SMS Database").* The administrative database system for toll free numbers. The Service Management System is a computer system that enables Responsible Organizations to enter and amend the data about toll free numbers within their control. The Service Management System shares this information with the Service Control Points. The entire system is the SMS database.

(e) *Toll Free Subscriber.* The entity that requests a Responsible Organization to reserve a toll free number from the SMS database.

(f) *Toll Free Number.* A telephone number for which the toll charges for completed calls are paid by the toll free subscriber. The toll free subscriber's specific

geographic location has no bearing on what toll free number it can obtain from the SMS database.

REASONS FOR DENYING THE WRIT

There are no compelling reasons to grant the writ and there are several reasons to deny it. First, the unique background of this private contract action makes this case inappropriate for certiorari review. Second, petitioners' invocation of public policy to avoid their valid contractual obligations is completely unpersuasive because the FCC policy has nothing to do with the contract at issue here. Third, petitioners did not raise the issue of primary versus secondary retroactivity on which they now predicate their request for a writ until they filed a petition for rehearing in the Seventh Circuit. Therefore, petitioners have not adequately preserved the issue for further review. Fourth, petitioners have not shown that the decision of the Seventh Circuit Court of Appeals conflicts with the decision of another Court of Appeals on "the same important matter." *See* Rule 10(a) of the Rules of the Supreme Court of the United States. Finally, petitioners err in arguing that a 1997 FCC regulation can be used to impair contractual obligations arising from private transactions legally entered into in the 1980's. Nothing in the language of the regulation suggests that the FCC intended that result, and use of the 1997 regulation in such a way would constitute impermissible retroactive agency action. Accordingly, the petition for a writ should be denied.

I. THE UNIQUE BACKGROUND OF THIS CASE MAKES IT INAPPROPRIATE FOR CERTIORARI REVIEW.

AT&T, then a legal monopoly as the sole provider of long distance telephone service, began to offer Wide Area Telecommunications Services ("WATS") in the early sixties. WATS permits a subscriber to pay a fixed charge rather than a charge assessed for each call. In order to protect its monopoly power, early AT&T tariffs prohibited subscribers from reselling or sharing WATS, since, if a subscriber did so, the practice would undermine AT&T's legal monopoly. The FCC became concerned that AT&T's prohibition of resale and sharing of WATS resulted in segmented markets and promoted harmful price discrimination. For that reason, the FCC, on December 18, 1980, ordered that tariff restrictions on resale and sharing of WATS were thereafter unlawful. *See, National Ass'n of Regulatory Util. Com'rs v. F.C.C.*, 746 F.2d 1492, 1495-1497 (D.C. Cir. 1984); *Resale and Shared Use*, 83 F.C.C.2d 167 (1980). By making tariff restrictions on resale unlawful, the FCC, in 1980, actually encouraged the sale of WATS by subscribers.

In 1967, AT&T, still a monopoly, began providing toll-free service permitting subscribers to pay in advance for all calls made to them. From 1967 to 1996, 1-800 was the only prefix available for toll-free service.

In 1977, AT&T assigned WATS toll-free No. 1-800-356-9377 to Madison Truck Brokers. In May, 1982, the number was assigned to 1-800-FLOWERS, Inc. (Wis.), a corporation controlled by respondent Curtis Jahn. That summer, Jahn and others test-marketed the 1-800-FLOWERS concept of selling floral products by telephone. In October, 1982, Jahn transferred control of the corporation to William Alexander pursuant to an agreement among four

individuals, including Alexander and Jahn, to market floral products using the 1-800-FLOWERS concept. Of the several agreements signed by the four parties, one contract gave Jahn a 1% royalty on all operating profits of the business, recognizing in part his earlier transfer of the number to the corporation. In 1986, the royalty agreement was modified at the request of the petitioners to 1% of net sales accomplished over the phone number. Royalty payments were made pursuant to the contract for many years before respondents discovered that petitioners breached the contract by failing to make full payment. After this lawsuit was filed to enforce the contract, petitioners for the first time asserted the contract violated public policy and was unenforceable. In making that argument, petitioners mischaracterize the public policy on which they claim reliance. That public policy is revealed by the history behind the enactment of 47 C.F.R. §52.107.

In 1995, the Federal Communications Commission (FCC) was advised by the telecommunication industry that the pool of available 800 numbers was rapidly declining. The FCC decided that rulemaking was necessary to promote the "efficient, fair and orderly allocation, and use of, these limited numbering resources." *Toll Free Service Access Codes, Notice of Proposed Rulemaking*, CC Docket No. 95-155, FCC No. 95-419, ¶¶1-10 (10/5/95).

After two years of hearings and comment, the FCC adopted regulations including 47 C.F.R. §52.107(a). When it did so, it repeated its rationale for the regulation; that is, to address the rapid and unanticipated depletion of 800 numbers. *Second Report & Order and Further Notice of Proposed Rulemaking, In the Matter of Toll-Free Service Access Codes*, CC Docket No. 95-155, 12 FCC Rcd 11, 162, at ¶¶1, 16 (4/11/97). The FCC determined that its statutory

authority required it to "ensure the efficient, fair and orderly *allocation* of toll free numbers." Second Order ¶18. (Emphasis added.) The Commission did *not* conclude that it intended to outlaw payments required by prior valid contracts, such as the one between petitioners and respondents, or that an attempt to invalidate such contracts would advance the Commission's allocation policy. Instead, the Commission wrote:

> We further find that number brokering, which is the selling of numbers by private entities for a fee, is not in the public interest. Brokering provides motivation for hoarding and therefore results in quicker exhaustion of the current SAC [Service Access Code such as 800, 888] and interferes with the orderly allocation of numbering resources.

Second Order, ¶38. Thus, the FCC's goal in enacting the regulation was to prevent hoarding and its public policy was to thereafter promote the fair, orderly and efficient allocation of toll-free numbers.

II. PETITIONERS' PUBLIC POLICY ARGUMENT IS WITHOUT MERIT.

The public policy of promoting the fair, orderly and efficient allocation of toll-free numbers is not implicated at all by the private contract between petitioners and respondents. The payments required by the 1982 transaction do not accelerate the depletion of toll-free numbers. The 1-800-FLOWERS number has always been used for a legitimate business interest. A refusal to enforce the contract in 2002 or any future time will have nothing to do with the orderly allocation of scarce resources. Petitioners ignore

these obvious facts in urging that public policy relieves them of their contractual obligations.

The conduct of petitioner, 1-800-FLOWERS.COM, Inc., is proof that the purpose and intent of the FCC regulation had nothing to do with the royalty agreement. This entity is a sophisticated user of more than ten toll-free vanity numbers. It filed comments with the FCC before the 1997 regulation was enacted. After the 1997 enactment, 1-800-FLOWERS.COM, Inc. continued to pay the royalty required by the contract involved in this case, because it was obvious the payments had nothing to do with the purpose and intent of the administrative rule expressed in §52.107. Only after being sued did petitioners look for an issue to avoid liability for their contractual obligations. This is not the sort of claim that warrants certiorari review.

III. CERTIORARI REVIEW IS INAPPROPRIATE BECAUSE PETITIONERS DID NOT DEVELOP AN ADEQUATE RECORD BELOW ON THE PRIMARY VERSUS SECONDARY RETROACTIVITY ISSUE ON WHICH THEY PREDICATE THEIR REQUEST FOR A WRIT.

Petitioners did not raise the primary versus secondary retroactivity argument for consideration by the Seventh Circuit Court of Appeals until they petitioned for a panel rehearing after the Court's opinion was issued. Even though respondents cited and relied on *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), in their appellate brief, petitioners did not discuss either *Landgraf* or *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), in their response brief to the Seventh Circuit. Petitioners now seek Supreme Court review without the benefit of full

briefs by the parties in the lower courts on the very issue presented and without the benefit of an analysis of the issue by either of the lower courts that have issued decisions in this case.

IV. PETITIONERS HAVE NOT SHOWN A CONFLICT BETWEEN THE DECISION BELOW AND THE DECISIONS OF OTHER COURTS OF APPEALS ON "THE SAME IMPORTANT MATTER."

With very little analysis, petitioners leap to the conclusion that the decision below conflicts with decisions issued by other circuits. Their argument that a split of authority exists on the secondary retroactivity issue is poorly developed and ill-conceived. Indeed, petitioners have not shown that the D.C. and Ninth Circuits, relying on their own precedents, would have decided this case any differently than the Seventh Circuit did. The mere mention of secondary retroactivity in some cases but not another surely does not mean that the cases conflict.

Viewed from that perspective, petitioners' purpose in citing *Federal Deposit Ins. Corp. v. D.L. Faulkner*, 991 F.2d 262, 266 (5th Cir. 1993), *Bergerco Canada v. U.S. Treasury Dept.*, 129 F.3d 189, 192 (D.C. Cir. 1997), and *Direct TV, Inc. v. Federal Communications Comm.*, 110 F.3d 816 (D.C. Cir. 1997), is obscure, since those cases do little more than mention secondary retroactivity. None of these decisions uses the principle of secondary retroactivity to invalidate payments required by a private contract entered into before the regulation or statute at issue was first effective. Indeed, none of the cases petitioners cite involve the invalidation of a pre-existing contractual arrangement by later legislation or rulemaking. That is probably because

such cases are extraordinarily rare. As this Court observed eight years ago in *Landgraf*, 511 U.S. at 271:

> The largest category of cases in which we have applied the presumption against statutory retroactivity has involved new provisions affecting contractual or property rights, matters in which predictability and stability are of prime importance.

In his concurrence in *Landgraf*, just as in his concurrence six years earlier in *Bowen*, 488 U.S. 204 (1988), Justice Scalia agreed with his brethren that retroactive legislation is looked upon with disfavor. *Bowen*, 488 U.S. at 223; *Landgraf*, 511 U.S. at 286. According to Justice Scalia, the critical issue in the retroactivity analysis is identifying the relevant activity the rule in question seeks to regulate. *Landgraf*, 511 U.S. at 291 (Scalia, J. concurring). Here, 47 C.F.R. §52.107(a) was aimed at protecting a scarce resource by preventing hoarding of that resource. Absent a clear statement to the contrary, only such relevant activity which occurs after the effective date of the regulation is covered by it. *Id.* This means that selling toll free numbers after 1997 is proscribed, but the sale of such numbers before then is unaffected by the rule.

This result obtains even if Justice Scalia's discussion of secondary retroactivity is applied. As he explained:

> A focus on the relevant retroactivity event also explains why the presumption against retroactivity is not violated by interpreting a statute to alter the future legal effect of past transactions – so-called secondary retroactivity. [Citations omitted.] A new ban on gambling applies to existing casinos and casinos under construction [citations omitted], even though it "attaches a new

> disability" to those past investments. The relevant retroactivity event is the primary activity of gambling, not the primary activity of constructing casinos.

Landgraf, 511 U.S. at 293, n. 3 (Scalia J., concurring). Here, the relevant retroactivity event is the primary activity of hoarding. Because that is the primary conduct being regulated, the rules against retroactive legislation would be violated if the 1997 proscription on selling could be applied retroactively to invalidate the consideration agreed upon in the 1980's for the sale of a business that included transfer of the valuable toll-free number 1-800-FLOWERS.

V. USE OF THE 1997 FCC REGULATION TO IMPAIR CONTRACTUAL OBLIGATIONS ARISING FROM PRIVATE TRANSACTIONS LEGALLY ENTERED INTO IN THE 1980'S WOULD VIOLATE THE RULES AGAINST RETROACTIVE AGENCY ACTION.

A fatal flaw in petitioners' case is the absence of any language in §52.107(1) purporting to change future consequences of past events. The Seventh Circuit held that "§52.107 does not purport to affect transactions entered into before 1997." App. 8a. Nothing in the regulation outlaws future periodic payments calculated to satisfy contractual obligations entered into before 1997. As stated by the Seventh Circuit, " . . . nothing in §52.107 speaks to payment; . . . . " App. 9a. Indeed, petitioners do not suggest that the transfer in 1982 of the valuable phone number 1-800-FLOWERS should be rescinded based on the 1997 FCC regulation. Rather, they argue only that their obligation to pay what they agreed to pay for that transfer should be erased. In short, they seek to retain all the

enormous benefits of the transfer without paying the agreed upon consideration.

Use of the 1997 regulation to absolve petitioners of their contractual obligations would be particularly unjust because the respondents were never subject to the regulation in the first place. A careful reading of §52.107, including the definitional sections, establishes that the regulation does not purport to regulate respondents. In 1982 and 1986, when the underlying contracts were executed, there was no "SMS Database" and there were no "Responsible Organizations" as defined by the FCC regulation. Jahn and Capitol were not "toll free subscribers" within the meaning of §52.107(a)(1). *See* 47 C.F.R. §52.101(b)(d) and (e). Nor could Jahn and Capitol be considered "toll free subscribers" today. Their use of the 1-800-FLOWERS number ceased in 1982, and they are not today asking to reserve this number from the SMS database. Jahn and Capitol are not now subject to FCC regulation and they have not been subject to FCC regulation since 1982. 1-800-FLOWERS.COM, of course, was a subscriber in 1997 and is now. But subsection (1) of §52.107(a) *does not* apply to buyers. Subsection (2) *does* apply to buyers, but the parties agree that the number was not acquired by 1-800-FLOWERS.COM "for the purpose of selling it to another" for a fee, so that subsection is inapplicable too. Thus, neither party to the underlying contract is subject to §52.107(a)(1) and enforcement of the contract could not possibly violate that section.

The language of §52.107 unequivocally establishes that the regulation was not intended to alter future payments based on a 1982 transaction. The regulation was narrowly and technically defined to govern only those

persons who might interfere with the "efficient, fair and orderly allocation of toll-free numbers" after 1997.

We know the FCC did not intend to regulate payments on old contracts because §52.107 was created to control the future allocation of a scarce resource. Despite that frequently-stated purpose, petitioners argue that the regulation should be construed to prevent future payments on old contracts, because, if the 1982 transaction had occurred in 1997, it would have violated the regulation. That is not true either, but, even if it were, petitioners' argument is untenable. In effect, petitioners suggest that whenever a regulation prospectively changes the legality of prior legal contracts, any performance required by the previously valid contract – such as periodic payments – is thereafter illegal even though the agency did not intend that result. That argument is an exercise in retroactivity; more importantly, it does not make sense.

Petitioners attempt to justify this result by relying on the doctrine of secondary retroactivity. Their reliance is misplaced. As the Seventh Circuit correctly observed:

> Federal regulations do not, indeed cannot, apply retroactively unless Congress has authorized that step explicitly. *See Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988). No statute authorizes the FCC to adopt regulations with retroactive effect, and §52.107 does not purport to affect transactions entered into before 1997.

App. 8a.

In *Landgraf*, 511 U.S. at 269, this Court adopted Justice Story's definition of retroactivity:

> "[E]very statute, which takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past, must be deemed retrospective . . . ."

Id., citing *Society for Propagation of the Gospel v. Wheeler*, 22 F. Cas. 756 (1814). Under that definition, use of the 1997 FCC regulation to foreclose future periodic payments on a sale that predated the regulation impairs vested rights and constitutes retroactive legislation.

In *Landgraf*, Justice Scalia objected to the majority's definition of retroactivity. *Landgraf*, 511 U.S. at 290. Six years earlier, in *Bowen*, 488 U.S. 204, Justice Scalia had pointed out the difference between retroactivity for a statute passed by Congress and retroactivity for an administrative regulation. He noted that Congress has the power to enact a statute with retroactive effect, but only if Congress does so expressly and only if retroactivity is reasonable.

The ability of a regulatory agency to enact retroactive rules and codes is different. Such an agency is generally precluded from enacting retroactive regulation under the Administrative Procedures Act unless Congress specifically gives such authority to the agency. *Bowen*, 488 U.S. 233-24. Congress gave no such authority to the Federal Communications Commission.

From those predicates, Judge Scalia argues that agency action may not alter past legal consequences, but may alter the future effects of past actions if it is reasonable for the agency to do so. *Bowen*, 488 U.S. at 224. In determining whether or not a rule alters past legal consequences, Justice Scalia suggests that a court examine "the relevant activity that the rule regulates." *Landgraf*, 511

U.S. at 291. In §52.107, the FCC did not seek to regulate future payments based on past contracts. Rather, it exercised its power over certain specifically defined future sales transactions in an effort to prevent future hoarding. To invalidate future payments mandated by a 1982 agreement is to engage in retroactive agency action. The end result would be the application of a 1997 FCC rule to invalidate a 1982 transaction that was perfectly valid when made.

For petitioners' argument on secondary retroactivity to have any merit, petitioners would also have to establish that the secondary retroactivity they seek is reasonable. That is because, as Justice Scalia explained in his *Bowen* concurrence, "[a] rule that has unreasonable secondary retroactivity – for example, altering future regulations in a manner that makes worthless substantial past investment incurred in reliance upon the prior rule – may for that reason be 'arbitrary' or 'capricious'. . . and thus invalid." *Bowen*, 488 U.S. at 220. Petitioners make no showing that retroactive application of §52.107 to allow them to evade their future contractual obligations from a 1982 contract satisfies any index of reasonableness.

On its face, a declaration that §52.107 prohibits payments based on a pre-1997 contract is unreasonable because such a declaration bears no relationship whatsoever to the unambiguous purpose of the FCC in an enacting the regulations. "[T]he inquiry must be whether the sanction of nonenforcement is consistent with and essential to effectuating the public policy embodied" in the regulation. *United States v. Mississippi Valley Generating Co.*, 364 U.S. 520, 563 (1961). The FCC's public policy embodied in the regulation is to protect a scarce resource after 1997. It has nothing to do with petitioners' contractual

duty to make royalty payments they agreed to make when they accepted transfer of the valuable 1-800-FLOWERS number from respondents in 1982.

CONCLUSION

Petitioners have not articulated any compelling reason to justify discretionary review by this Court. Accordingly, respondents respectfully urge the Court to deny petitioners' petition for writ of certiorari.

Respectfully submitted,

EARL H. MUNSON
Counsel of Record
CATHERINE M. ROTTIER
BOARDMAN, SUHR, CURRY & FIELD LLP
1 South Pinckney Street, Suite 410
P.O. Box 927
Madison, Wisconsin 53701-0927
(608) 257-9521
Counsel for Respondents

Supreme Court, U.S.
FILED
AUG 22 2002
OFFICE OF THE CLERK

(3)

No. 02-71

In the Supreme Court of the United States

1-800-FLOWERS.COM, INCORPORATED,
FRESH INTELLECTUAL PROPERTIES, INCORPORATED,
AND 800-FLOWERS, INCORPORATED,
Petitioners,

v.

CURTIS P. JAHN AND
CAPITOL WAREHOUSING CORPORATION,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY TO BRIEF IN OPPOSITION

WILLIAM M. CONLEY
Counsel of Record
SHARON MCLLMAN ELLIOTT
FOLEY & LARDNER
150 E. GILMAN STREET
POST OFFICE BOX 1497
MADISON, WI 53701
(608) 257-5035

Counsel for Petitioners

BECKER GALLAGHER LEGAL PUBLISHING, INC.,
CINCINNATI, OHIO 800-890-5001

10 pp

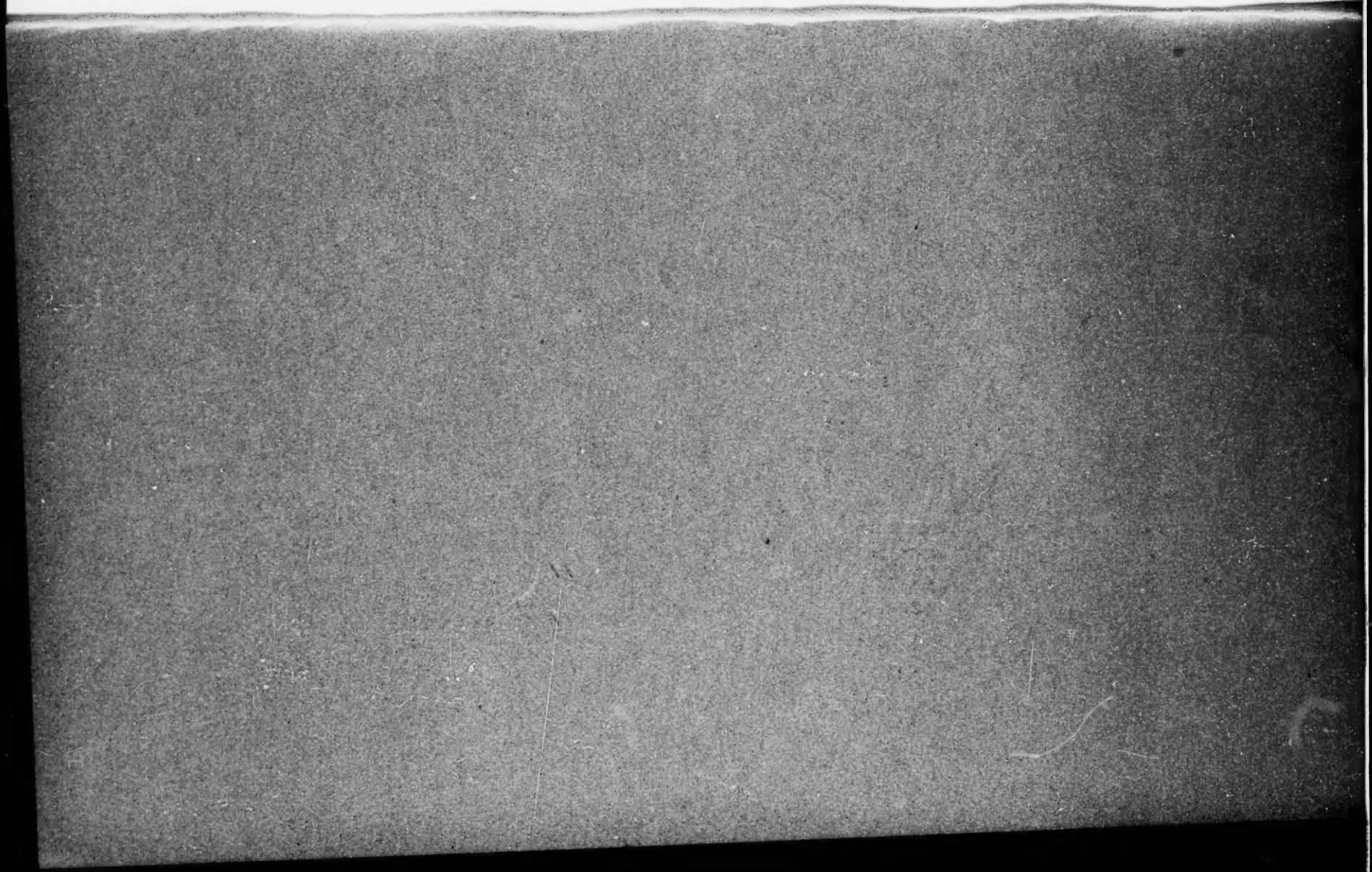

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

REPLY FOR PETITIONER 1

1. The FCC policy expressly prohibits the sale of a single toll free number 2

2. Respondents are "toll free subscribers" as defined by the rule. 3

3. The secondary retroactivity issue is ripe for review. 4

4. The FCC rule is reasonable and should be enforced against an assertion of retroactivity. 5

5. Contracts that violate federal law and public policy should not be enforced. . . . 6

CONCLUSION 6

TABLE OF AUTHORITIES

FEDERAL CASES

Bowen v. Georgetown University Hospital,
488 U.S. 204 (1988) 5

FCC Letter to Mr. Joseph Weiss,
13 F.C.C.R. 4122 (1977) 2, 4

Hurd v. Hodge,
334 U.S. 24 (1948) 6

Landgraf v. USI Film Products,
511 U.S. 244 (1994) 5

Louisville & Nashville R.R. v. Mottley,
219 U.S. 467 (1911) 6

Norman v. Baltimore & Ohio R.R.,
294 U.S. 240 (1935) 6

Patients Plus, Inc. v. Long Distance Telecommunications Service, Inc.,
13 F.C.C.R. 5827 (1997) 4

W.R. Grace & Co. v. Local Union 759,
461 U.S. 757 (1983) 6

FEDERAL REGULATIONS

47 C.F.R. § 52.107 2-4

ADMINISTRATIVE ORDERS

Second Report and Order and Further Notice of Proposed Rulemaking, In the Matter of Toll Free Service Access Codes, 12 F.C.C.R. 11,162 (Apr. 11, 1997) 2, 5

REPLY FOR PETITIONER

Respondents take great pains to portray this case as too complicated and unique for review. Eschewing any citations to the record, respondents state "facts" that are completely contrary to the uncontested findings of the district court. *Compare, e.g.*, Brief in Opposition ("Opp.") 9 (describing the royalty as consideration "for the sale of a business") *with* App. 25a (finding that the "royalty was paid as consideration for plaintiffs' transfer of the FLOWERS [toll free] number"). Fanning the smoke a little further, they recite a history of the reselling of phone *service* that is completely unrelated to the FCC rule prohibiting sale of a phone *number* at issue here. Opp. 3. To complete the misdirection, respondents repeatedly stress the mantra that the public policy behind the FCC rule was to protect scarce resources.

The essential facts and the law are much more straightforward: Jahn sold a toll-free phone number in exchange for perpetual royalty payments; the FCC later promulgated a rule formalizing its long-standing policy against the sale of a phone number for a fee; the continuing obligation to pay Jahn for the sale of the toll-free number violates both that FCC rule and policy; and Jahn nevertheless seeks to enforce a contract requiring such future payment. The discrete, basic facts provide this Court with a solid foundation for (1) resolving a conflict in the circuits over the requirement of congressional authorization for administrative rules affecting future consequences (secondary retroactivity) and those affecting completed events (primary retroactivity), and (2) affirming the continued vitality of this Court's historic decisions rejecting enforcement of contracts that violate public policy. Both are sufficiently important issues to justify granting certiorari.

i. The FCC policy expressly prohibits the sale of a single toll free number.

Claiming that petitioners have "mischaracterized the public policy," respondents go through a detailed exposition on the "history behind the enactment of 47 C.F.R. § 52.107" to "reveal" what they claim is the real public policy behind the ban on toll-free number sales. Opp. 4-5. Finding that policy to be the "orderly allocation of scarce resources," respondents then argue that applying the ban on sales of toll-free numbers to Jahn's sale does not implicate the allocation of scarce resources. Opp. 5-6. One little sale, they argue, hardly "accelerate[s] the depletion of toll-free numbers." Opp. 5.

That is not what the FCC says. In its *Second Report and Order and Further Notice of Proposed Rulemaking, In the Matter of Toll Free Service Access Codes,* 12 F.C.C.R. 11,162 at 11,186 (Apr. 11, 1997) (*"Second Report and Order"*), the FCC concluded that the sale of even a single number by a private entity for a fee offends the public interest because it "provides motivation for hoarding and therefore results in quicker exhaustion" and "interferes with the orderly allocation of numbering resources." *Id.* at 11,189. Indeed, the FCC confirmed its intent to apply its rule to the sale of a single number within days of the rule's effective date. *See FCC Letter to Mr. Joseph Weiss*, 13 F.C.C.R. 4122 (June 13, 1997) (applying rule to circumstances involving attempted transfer of a single toll free number for profit and admonishing Weiss for treating a toll free number as a commodity).

2. Respondents are "toll free subscribers" as defined by the rule.

Respondents also argue that the FCC rule does not apply to them because Jahn and Capitol Warehousing were not "toll free subscribers" within the meaning of 47 C.F.R. § 52.107, and because the "Responsible Organizations" and "SMS Database" referenced in the rule did not exist in the 1980s. Opp. 10. That argument places an unreasonably narrow construction on the rule. The reference to "Responsible Organizations" or "RespOrgs" and to "SMS Database" or "SMS" in the definition of "subscriber" merely reflects the current terminology used to describe one who receives a toll free number from a provider. The fact that toll free numbers were allocated by AT&T (which under today's regulatory scheme is a RespOrg) when the FLOWERS toll free number was originally assigned to Jahn in 1976 does not render him something other than a subscriber of toll free service under the rule.

Even if 47 C.F.R. § 52.107(a) were construed not to reach beyond current subscribers, the tariff provision in § 52.107(b), which the FCC expressly mandates "be included in the Service Management System tariff and in the local exchange carriers' toll free database access tariffs," prohibits the act of selling a toll free number for a fee:

> The Federal Communications Commission ("FCC") has concluded that hoarding, defined as the acquisition of more toll free numbers than one intends to use for the provision of toll free service, *as well as the sale of a toll free number by a private entity for a fee*, is contrary to the public interest in the conservation of the scarce toll free number

> resource and contrary to the FCC's responsibility to promote the orderly use and allocation of toll free numbers.

47 C.F.R. § 52.107(b) (emphasis added).

Moreover, contrary to respondents' assertion, nothing in the rule limits its application to those who sold a number after the rule's promulgation. Indeed, the FCC has applied the 1997 rule to conduct that predates its enactment. *See Patients Plus, Inc. v. Long Distance Telecomms. Serv. Inc.*, 13 F.C.C.R. 5827 (Aug. 28, 1997) (applying the rule to conduct which occurred between 1991-1993); *FCC Letter to Mr. Joseph J. Weiss,* 13 F.C.C.R. 4122 (June 13, 1997) (applying the rule and admonishing conduct which occurred in 1996).

3. The secondary retroactivity issue is ripe for review.

Respondents also point out that petitioners did not raise the primary versus secondary retroactivity argument until their petition for rehearing. Opp. 6. For good reason: the distinction did not come into play until the Seventh Circuit - addressing an issue of retroactivity that the district court found no need to reach - held that express congressional authorization was required for the FCC rule to apply to Jahn's sale of a toll-free number. App. 8a. Such authorization is needed only for rules with primary retroactivity (Pet. 6-8); until the Seventh Circuit *sua sponte* raised the requirement of express congressional authorization, the distinction between primary and secondary retroactivity was not an issue. Moreover, petitioners gave the Seventh Circuit the opportunity to address the distinction by briefing the issue in a petition for rehearing.

4. The FCC rule is reasonable and should be enforced against an assertion of retroactivity.

Respondents erroneously argue that the FCC rule is unenforceable under the rules of retroactivity. First, the Seventh Circuit's decision is inconsistent with this Court's decision in *Landgraf v. USI Film Prods.*, 511 U.S. 244 (1994). Under the holding of that case, a rule is impermissibly retroactive only if it creates new legal consequences for events *completed* before its enactment. *See* Pet. 9-10. In this case, the relevant events are by definition not completed because respondents chose to take payment in the form of perpetual royalties for the sale of the toll-free number. Petitioners seek only to void any obligation to make future payments.

Second, if this Court expressly adopts Justice Scalia's distinction between primary and secondary retroactivity, as have the D.C. and Ninth Circuits (Pet. at 7), then the Seventh Circuit's decision must be reversed because the FCC's rule is plainly a reasonable exercise of that agency's authority. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 220 (1988) (Scalia, J., concurring). Under Justice Scalia's "reasonableness" test, a rule with only secondary retroactive effects will be upheld if it is not arbitrary and capricious. *Bowen*, 488 U.S. at 220. In this instance, the FCC has articulated a persuasive rationale for prohibiting the sale of toll-free phone numbers: the sale of even a single number by a private entity for a fee offends the public interest because it "provides the motivation for hoarding and therefore results in quicker exhaustion" and "interferes with the orderly allocation of numbering resources." *Second Report and Order* at 11,189.

5. Contracts that violate federal law and public policy should not be enforced.

Respondents do not even address the Seventh Circuit's conflict with this Court's decisions forbidding enforcement of private contracts that violate federal law and policy. *See* Pet. 10-13. Even if a contract is lawful when made, federal courts may not enforce it if enforcement would violate federal law or frustrate public policy - even if that law or policy was promulgated or announced after the contract was entered. *See, e.g., W.R. Grace & Co. v. Local Union* 759, 461 U.S. 757 (1983); *Hurd v. Hodge*, 334 U.S. 24 (1948); *Norman v. Baltimore & Ohio R.R.*, 294 U.S. 240, 307, 308, 311 (1935); *Louisville & Nashville R.R. v. Mottley*, 219 U.S. 467, 485 (1911). The Seventh Circuit ignored this historic rule. This Court now has the opportunity to emphasize the importance and continuing vitality of these earlier decisions.

CONCLUSION

For the reasons stated above and in the petition, the writ of certiorari should be granted.

Respectfully submitted,

WILLIAM M. CONLEY
Counsel of Record
SHARON MOLLMAN ELLIOTT
FOLEY & LARDNER
150 E. Gilman Street
Post Office Box 1497
Madison, WI 53701
(608) 257-5035
Counsel for Petitioners

August 20, 2002